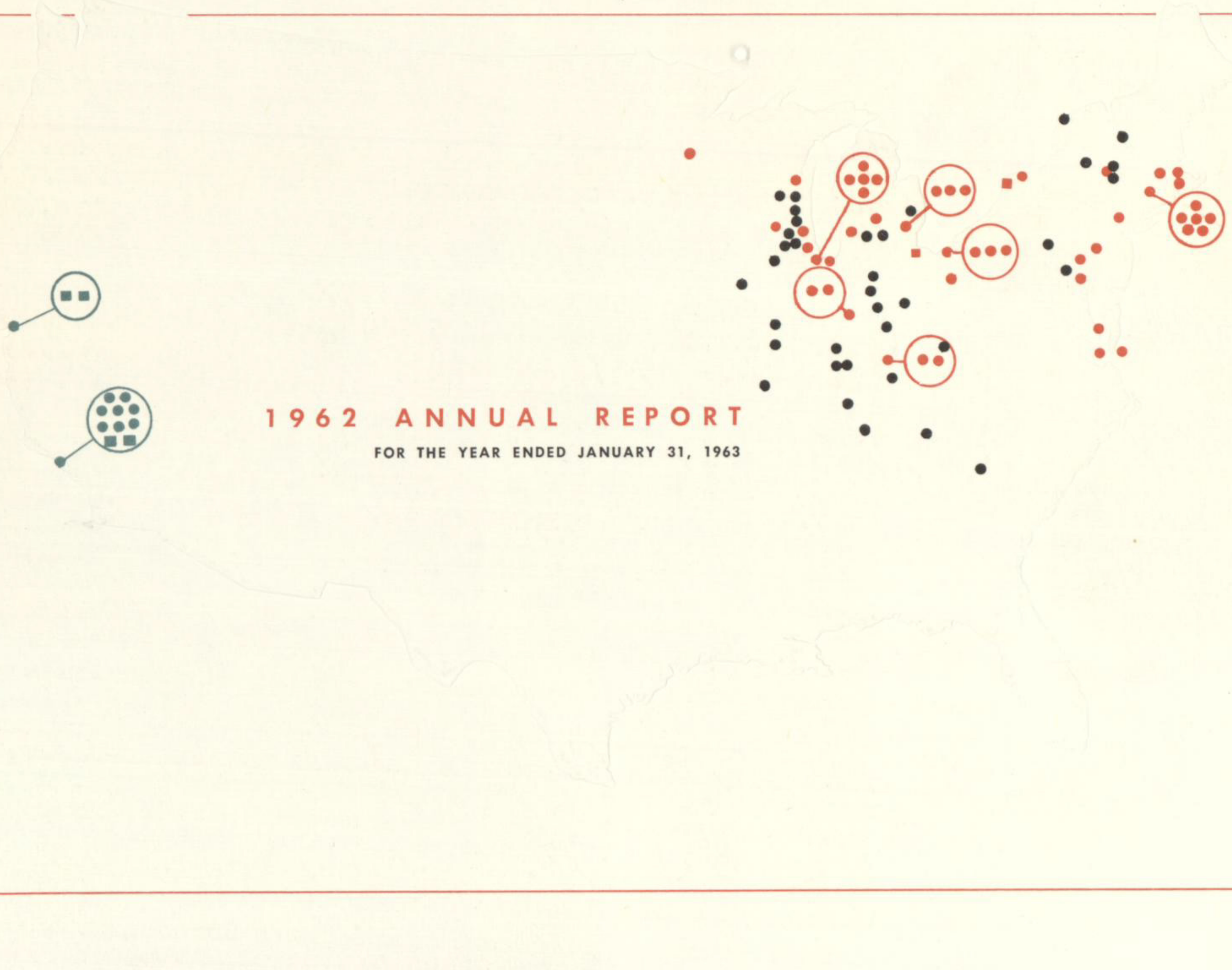
Interstate Department Stores, inc.



1962 ANNUAL REPORT

FOR THE YEAR ENDED JANUARY 31, 1963

DISCOUNT STORES

White Front Stores

CALIFORNIA	Anaheim Canoga Park** Covina East Los Angeles Los Angeles West Los Angeles Oakland** Pacoima** San Jose** San Bernadino Torrance* Van Nuys

Topps Stores

CONNECTICUT	Berlin Fairfield Hartford—Windsor East Hartford Middletown West Haven
ILLINOIS	Chicago—Addison Chicago—Arlington Heights Chicago—LaGrange Chicago—Niles Chicago Heights Joliet Waukegan
INDIANA	Highland Indianapolis—38th Street Indianapolis—Speedway
MARYLAND	Baltimore
MASSACHUSETTS	Brockton Fall River (Kerr Mill Bargain Center) West Springfield
MICHIGAN	Detroit—Oak Park Detroit—Redford Detroit—Warren Kalamazoo Lansing
MINNESOTA	Minneapolis
NEW JERSEY	Totowa, Rt. 46*
NEW YORK	Albany Rochester* Buffalo**
OHIO	Cleveland—Maple Heights Cleveland—Mayfield Heights Cleveland—Parma Heights Toledo**
PENNSYLVANIA	Lancaster (Maple Grove Bargain Center)
WISCONSIN	Green Bay Madison

Family Fair Stores

KENTUCKY	Louisville—Algonquin Plaza Louisville—Hikes Point
OHIO	Canton
PENNSYLVANIA	Coplay (Discount Fair)

*Opened 1963
**To be opened in 1963

DOWNTOWN DEPARTMENT STORES

ILLINOIS	Aurora Dry Goods Co., Aurora Carroll House, Belleville Peoria Dry Goods, Peoria Rockford Dry Goods, Rockford Springfield Dry Goods Co., Springfield Waukegan Dry Goods Co., Waukegan
INDIANA	The Evansville Store, Evansville Stillman's, Fort Wayne Hill's, Marion Stillman's, Muncie Hill's, Vincennes
IOWA	Hill's, Davenport
KENTUCKY	Paducah Dry Goods Co., Paducah Jefferson Dry Goods, Louisville
MICHIGAN	George W. Toeller Co., Battle Creek Stillman's, Jackson Carroll House, Port Huron
NEW YORK	Stanley's, Troy Boston Store, Utica
OHIO	The Boston Store, Springfield
PENNSYLVANIA	Carroll House, Williamsport Stillman's, York
SOUTH CAROLINA	Bailes, Anderson
TENNESSEE	The Knox, Knoxville
VERMONT	Economy Department Store, Rutland
WEST VIRGINIA	The Huntington Store, Huntington
WISCONSIN	Fond du Lac Department Store, Fond du Lac Hill's Department Store, Milwaukee Racine Dry Goods Co., Racine Hill's Department Store, Sheboygan

SUBURBAN STORES

ILLINOIS	Rockford Dry Goods, Loves Park
INDIANA	The Evansville Store, Lawndale Stillman's, South Gate
MICHIGAN	The Fair, Flint
NEW YORK	Boston Store, Latham Boston Store, Massena

THE COVER

Interstate's objective is to create a nation-wide retail organization consisting of conventional as well as new types of retail operations.

The map on the cover of this report and the list on the back of this gatefold illustrate the progress of the Company in achieving this objective.

By the end of 1962, Interstate had 44 discount operations and 36 department stores, including 6 suburban branch units. Since then three more discount stores have been added, and by the end of the current year the discount group is expected to number between 52 and 54 units.

There are significant growth opportunities ahead for both discount and conventional department store operations. With balanced interests in each field, Interstate expects to participate actively in their growth.

Key to cover:
White Front Discount stores ●
Topps Discount Stores ●
Discount stores to be opened later this year ■ ■
Downtown and suburban department stores ●

turn

COMPARATIVE HIGHLIGHTS

	1962	1961
Total sales	$222,807,300	$165,219,000
Net income before taxes	$ 5,249,600	$ 3,829,400
Net income after taxes	$ 2,909,600	$ 2,079,400
Earnings per share	$ 2.40	$ 1.73*
Dividends per share – cash	$ .50	$ .44*
Stock dividends	4%	2%
Working capital	$ 14,786,500	$ 14,904,700
Stockholders' equity	$ 23,218,900	$ 20,620,600

*Based on the average number of shares outstanding after giving effect to the stock dividend distributed in 1962.

FIVE YEAR FINANCIAL REVIEW

	1962	1961	1960	1959	1958
Total sales	$222,807,300	$165,219,000	$114,311,400	$ 90,316,000	$ 65,674,300
Discount store sales	$167,481,200	$108,462,200	$ 55,255,500	$ 26,620,900	$ 687,800
Conventional store sales	$ 55,326,100	$ 56,756,800	$ 59,055,900	$ 63,695,100	$ 64,986,500
Net income before taxes	$ 5,249,600	$ 3,829,400	$ 2,385,800	$ 2,309,300	$ 1,005,700
Net income after taxes	$ 2,909,600	$ 2,079,400	$ 1,490,800	$ 1,394,300	$ 645,700
Earnings per share*	$ 2.40	$ 1.73	$ 1.28	$ 1.25	$ .61
Dividends per share – cash*	$ .50	$ .44	$ .37	$ .36	$ .27
Stock dividends (declared)	4%	2%	5%	3%	3%
Stock split	—	3 for 1	—	—	—
Working capital	$ 14,786,500	$ 14,904,700	$ 10,661,900	$ 12,798,700	$ 13,626,100
Current ratio	1.5 to 1	1.9 to 1	1.7 to 1	2.6 to 1	3.6 to 1
Fixed assets	$ 9,780,600	$ 8,340,300	$ 7,698,700	$ 6,875,800	$ 6,504,700
Long term debt	$ 5,962,700	$ 6,961,000	$ 3,336,800	$ 3,749,200	$ 4,978,200
Stockholders' equity	$ 23,218,900	$ 20,620,600	$ 18,917,800	$ 17,051,300	$ 15,586,300
Stockholders' equity per share*	$ 19.13	$ 17.23	$ 16.31	$ 15.23	$ 14.61
Number of discount stores	44	25	20	5	1
Number of conventional stores	36	37	41	46	46

*Based on the average number of shares in each year, adjusted to give effect to all stock dividends distributed through January 31, 1963, and the 3 for 1 stock split distributed June 23, 1961.

TO OUR STOCKHOLDERS:

As is customary, we will review in the pages that follow the progress of the Company during the year that ended January 31, 1963, and will discuss its outlook. In addition, sufficient time has passed since the current program of expansion was started in the Spring of 1959 to be able to examine and report on the Company's progress from a long range point of view, as well.

This program of growth has been the most important ever undertaken by the Company. Its accomplishments have been many. It has transformed the Company from a junior department store chain to a major factor in retailing.

This report is presented under the following subject headings: Sales and Earnings, Dividends, Financial Progress, Expansion in Low Markup Retailing, Modernization of Conventional Stores, Personnel, and Outlook.

Sales and Earnings

The year that ended January 31, 1963 was the most successful year in the Company's history. More stores were opened in that year than in any other, and sales and earnings showed greater dollar increases than ever before.

Sales totalled \$222.8 million, which compares with \$165.2 million for the prior year, and \$65.7 million for 1958, the last year before our expansion into the field of self-service retailing.

Net earnings rose to \$2.9 million, an increase of 43 per cent over the \$2.1 million earned the previous year. It compares with \$645 thousand earned in 1958.

On a share basis, Interstate earned \$2.40 on the average number of shares outstanding for the year. In 1961 the Company earned \$1.73 on the average then outstanding, and in 1958 share earnings were \$.61 on the same basis.

The improvement in earnings is all the more significant in view of the substantial expenses incurred in opening the

STATEMENT OF SOURCES AND APPLICATION OF FUNDS

FOR FOUR YEAR PERIOD ENDING JANUARY 31, 1963

SOURCES OF FUNDS

Net earnings	$ 7,874,100
Depreciation and amortization	3,718,800
Stock issued for acquisition of subsidiaries	1,240,000
Stock issued for option and bond conversion	695,700
Debentures issued	5,244,200
Increase in deferred Federal tax	501,000
	$19,273,800

APPLICATION OF FUNDS

Cash dividends	$ 2,182,800
Decrease in long term loan	4,330,000
Cost of intangibles applicable to subsidiaries acquired	3,594,200
Fixed assets acquired under modernization and expansion program	6,994,700
Increase in deferred charges	707,800
Other items net	304,000
Increase in working capital	1,160,300
	$19,273,800

44 stores added in this period and in building the headquarters and field organizations to operate the chain.

To summarize, Interstate's sales rose 239 per cent since 1958, dollar earnings increased 350 per cent, and per share earnings were up 293 per cent.

Dividends

Improvement in the Company's dividend program has kept pace with operating performance. In the four year period since February 1, 1959, Interstate has declared a 3 for 1 stock split, which occurred in 1961, and declared stock dividends at each year-end: 3 per cent in 1959, 5 per cent in 1960, 2 per cent in 1961, and 4 per cent last year.

Cash dividends have been increased on three occasions since the beginning of 1959. The rate in 1959, adjusted for the split in 1961, was \$.40 annually. In 1961 the annual rate was increased to \$.50 per share annually, and on January 3, 1963 a new rate of \$.60 annually was established.

As a result of the stock split and stock dividends, a stockholder today has 3.44 shares or their equivalent in cash for each share that he owned in 1959.

Financial Progress

In the four year period through the end of the last fiscal year, Interstate generated \$18,778,400 in new funds. These funds were obtained primarily from the following sources: net earnings contributed \$7,874,100, depreciation and amortization allowances \$3,718,800, the issue of 4⅝% Convertible Subordinated Debentures \$5,244,200, and an issue of common stock supplied \$1,240,000.

The funds were used mainly for the purpose of financing the Company's growth, the payment of dividends, the reduction of debt, and improvement of working capital.

Interstate's investment in fixed assets rose \$6,994,700 between February 1, 1959 and January 31, 1963. The assets included fixtures and equipment of its Topps and White Front self-service stores, as well as leasehold improvements made in conventional downtown and suburban stores.

Funds were also used to decrease the Company's long-

term debt. Its long-term loan, which amounted to $2,520,000 on February 1, 1959, was repaid during this period, and its loan with an insurance company was reduced by $1,810,000. Its total long-term debt now stands at $5,963,000.

Cash dividends, totalling $2,182,800 were paid in this four year period, and working capital was increased by $1,160,300.

Expansion in Low Markup Retailing

The dramatic growth in sales and earnings that has taken place since 1959 has been due primarily to the Company's rapid expansion in the self-service discount department store field.

Four years ago Interstate was unknown in this field. Today, with a chain of 47 discount stores across the country, including three added in the current year, the Company is one of the industry's leading factors.

Discounting has truly revolutionized retailing. There is hardly a community of any significant size in the country today where there is not a discount store, and if it's a bustling metropolis it probably has several. Most of these stores have come into being during the last few years, though a few trace their beginnings to the late 40's and early 50's.

Today, there are over 2,500 discount stores throughout the country, and it has been estimated that these stores did an aggregate volume of about $6 billion during 1962.

Interstate's first step was the acquisition in the Spring of 1959 of White Front Stores, Inc., a two-store chain in Los Angeles, with annual sales of about $20 million. Shortly thereafter Interstate opened discount stores in the mid-west under the name Family Fair. By the end of its first year in discounting, Interstate had five discount stores, which contributed about $25 million to the Company's sales that year.

The Company moved rapidly ahead with the expansion of its White Front operations in California. A third White Front store was opened late in 1960, and this was the largest in the group at that time, with over 100,000 square feet of selling space. In 1961 and 1962 four additional White Front units were opened, all in the greater Los Angeles area, and

early in the current year its eighth was opened in Torrance, California.

Another significant development was the acquisition of the Topps discount stores in 1960. There were 10 stores in the Topps group at that time. By the end of 1962, the chain had grown to 33 stores, located primarily in the east and midwest.

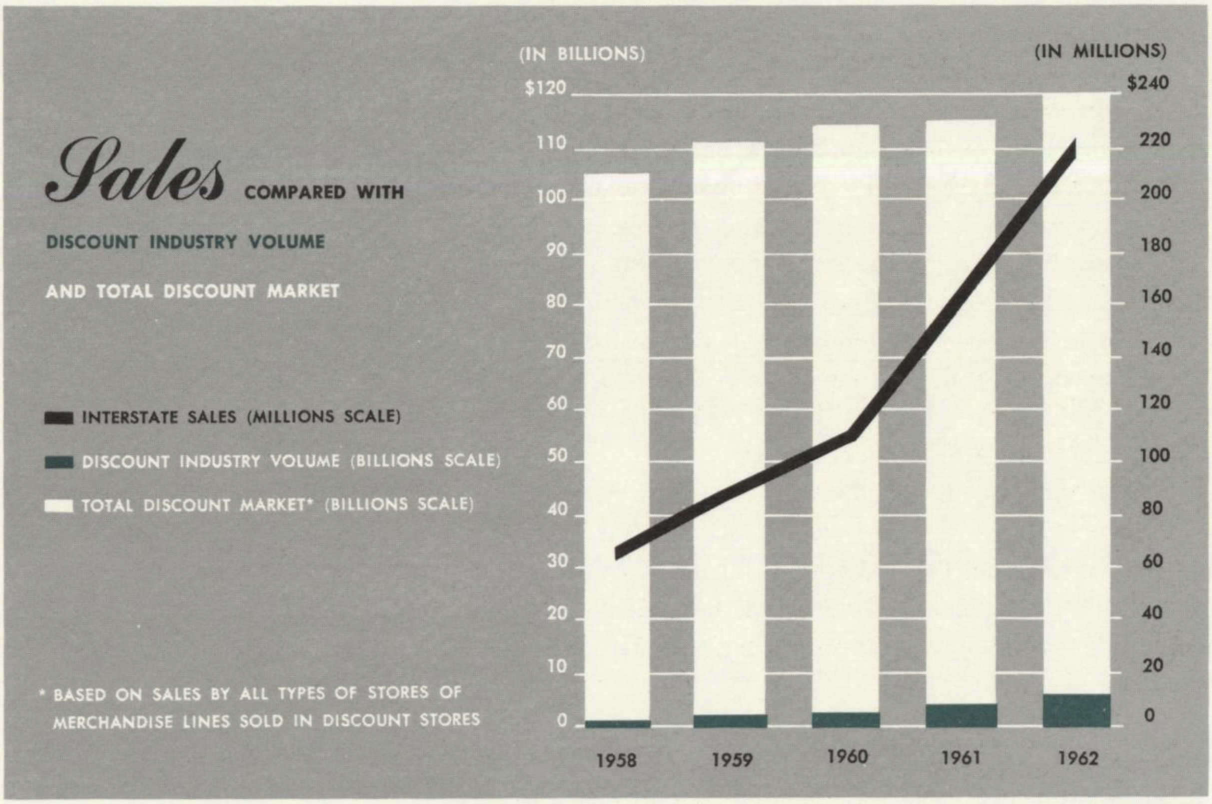
Since the start of the current year, two more Topps stores have been opened, one in Rochester, New York, and the other in Totowa, New Jersey. The Totowa store is the first Interstate store in the greater New York area, and is the largest in the entire chain, with 150,000 square feet of floor space, including a food supermarket.

Last year was the most active year in Interstate's history, with nineteen new discount stores added to the chain. The 44-store chain contributed about $170 million to Interstate's volume in 1962, and if all the stores had been in operation for a full year their volume would have approximated $220 million.

The discount field has become increasingly competitive as a result of the industry's rapid expansion. This has caused financial problems among the marginal operators. The stronger chains, however, with adequate financing and management resources, have continued to grow and have strengthened their positions in the market.

Of particular significance to the future of discounting is the fact that the potential market for discounters is many times greater than its present size. The market for discounters can be described as the total retail sales by all types of stores of product lines carried by discount stores. In 1958, total sales by all types of stores of durable and non-durable goods carried by discounters amounted to $105 billion, and discounters supplied an estimated 1.4 per cent of this market. In 1961 the market grew to about $115 billion, and it is estimated that discounters accounted for about 4.2 per cent, or $4.8 billion. In the year just ended, discounters share ran about 5 per cent of a market of approximately $120 billion, or about $6 billion.

Retail economists look for a continuation of this trend.



In our view discount stores can ultimately account for as much as 20 per cent of total retail sales of product lines carried by discounters. This would mean a discount industry with total annual volume of approximately $25 billion, which could be achieved within the next ten year period.

In line with this anticipated growth, Interstate is moving ahead with its expansion plans. In the current fiscal year, the Company will open between 8 and 10 new stores, six of which will be located on the west coast. An important step in this expansion program will be our entrance this year into the greater San Francisco market, where we hope to attain a pre-eminent position similar to the one we enjoy in the Los Angeles area.

Not all of the emphasis this year will be placed on the opening of new stores, however. After four years of continuous and rapid expansion, there are important benefits to be derived from consolidating our gains.

From a long range point of view, there are bound to be further modifications in the techniques of discounting, just as there have been numerous changes and improvements since discounting was introduced some fifteen years ago. The word "discounting" may itself disappear, for it has never adequately described this new form of retailing. Interstate will continue to concentrate on the development and improvement of techniques of self-service, mass-merchandising, and low markup retailing.

Modernization of Conventional Stores

In planning its growth, the Company has been guided by the conviction that certain key downtown department stores in each community will not only survive the inroads of discounting, but will grow and prosper as they continue to serve the whole community's needs for fashion, service, and a broad spectrum of prices from which to choose.

During the period of expansion in discounting, Interstate has also taken important steps to strengthen its position in the field of conventional retailing. This phase of the Company's rebuilding program started seven years ago, and during this period it has invested approximately $8 million in modernizing its key downtown department stores.

Each of the Company's conventional department stores has been put to the test: Is it now a primary store in its community? If not, can it be made a primary store?

If the answer to the two-part question is negative, steps are taken to dispose of the store, either by selling it, if possible, or closing it down when its lease expires. Since this appraisal program started in 1957, a total of 12 stores have been either sold or closed, leaving a balance of 36 at the end of the last fiscal year. Two more are scheduled to be closed during the current year and an additional two in 1964. That will complete the "pruning" program as we see it at the present time.

Investments have been made in many of the Company's conventional stores to improve and modernize their appearance and facilities. In the case of approximately half, the investments have been substantial. The improvements have ranged from the installation of new fixtures to comprehensive rebuilding and modernization.

Expansion of the Boston Store in downtown Utica, New York, was completed this Spring. The store is completely new from top to bottom, and is approximately twice the size of the original store.

A dramatic example of an extensive program was the opening in the Spring of the current year of the new and enlarged Boston Store in Utica, New York. The new store, with over 150,000 square feet of floor space on four floors, is approximately double the size of the original store. Over $1.5 million have been invested to make the Boston Store a completely new store from top to bottom, with new fixtures, new decor, new exterior, new and enlarged departments, a broader selection of merchandise, a more extensive spectrum of prices, new services, and many other new features to make shopping a treat for the family. Long the dominant store in the Utica Community, the expanded Boston Store is expected to double its sales volume and to extend its influence to areas 50 miles or more from Utica.

Though the Utica program is more extensive than any other modernization program that the Company has undertaken in recent years, it is nevertheless indicative of the confidence which the Company has in the future of strong downtown stores and of the scope of the Company's efforts to establish its downtown stores as key stores in their communities. Programs are presently underway for strengthening

other downtown stores and for opening new branch stores.

Personnel

An accomplishment of major importance in this four year period has been the building of a capable organization at headquarters and in the field to manage the Company's expansion and its recasting of downtown store operations.

Creating and training such an organization has involved substantial expenditures, which, of necessity, had to be made well in advance and in anticipation of the Company's growth.

The Company's management organization has been substantially strengthened and augmented by the personnel who came to Interstate through the mergers with the White Front and Topps retail operations.

These personnel, as well as members of the original Interstate organization, have turned in outstanding performances in making possible the great gains achieved by the Company in this period. The Board of Directors wishes to take this opportunity to recognize their important contributions to the Company's growth.

Outlook

Our overall objective has been to re-construct the Company, and to establish it as a major factor in retailing. We have made very significant progress in both discounting and conventional retailing, and we propose to continue our program along present lines. There will be more emphasis in the short term future on consolidating our gains. Nevertheless, our expansion program will continue. It is our objective to build a national reputation for the Company as a successful, profitable, and growing retailer, whose interests are broad and include such diverse fields as discount operations, downtown department stores, and suburban stores. We feel our list of interests should continue to be flexible, always allowing for our participation in the future revolutions in retailing.

Sincerely,

M. D. Safanie — S. W. Cantor

M. D. SAFANIE
Chairman

S. W. CANTOR
President

CONSOLIDATED

ASSETS

	1962 (As at Jan. 31, 1963)		1961 (As at Jan. 31, 1962)	
Current Assets:				
Cash		**$ 2,255,262**		$ 1,494,642
United States Treasury Bills—at cost, plus accrued interest		**999,444**		
Accounts receivable:				
Customers	**$ 7,489,491**		$ 6,413,417	
Less: Reserves	**391,423**	**7,098,068**	347,074	6,066,343
Other		**1,751,043**		1,929,426
Merchandise inventories (Note B)		**30,167,070**		21,658,012
Prepaid expenses		**1,043,707**		622,142
Fixed assets held for resale (Note I)		**1,314,289**		590,955
Total Current Assets		**44,628,883**		32,361,520
Other Assets		**427,421**		447,452
Fixed Assets—at cost (Note D):				
Land, land improvements and buildings	**897,325**		870,208	
Furniture and equipment	**7,975,260**		6,474,846	
Leaseholds and leasehold improvements	**7,085,485**		7,100,151	
	15,958,070		14,445,205	
Less: Reserves for depreciation and amortization	**6,177,478**	**9,780,592**	6,104,903	8,340,302
Deferred Charges (including pre-opening expenses of $897,516 and $254,676, respectively)		**1,238,906**		524,935
Intangibles Applicable to Subsidiaries Acquired (Note A)		**3,594,198**		3,594,198
		$59,670,000		$45,268,407

See accompanying notes.

BALANCE SHEET

LIABILITIES

	1962 (As at Jan. 31, 1963)	1961 (As at Jan. 31, 1962)
Current Liabilities:		
Notes Payable:		
Banks (Note C)	**$ 7,000,000**	
Other (Note I)	**1,150,000**	
Current installments of long-term debt (Note D)	**614,973**	$ 2,051,103
Accounts payable—trade	**14,368,489**	9,847,833
Accrued expenses and other liabilities	**3,206,383**	2,732,407
Taxes withheld and accrued, other than Federal income taxes	**1,667,358**	1,290,368
Accrued Federal income taxes (Note E)	**1,835,195**	1,535,138
Total Current Liabilities	**29,842,398**	17,456,849
Deferred Federal Income Taxes	**646,000**	230,000
Long-term Debt (Note D)	**5,962,671**	6,960,967
Total Liabilities	**36,451,069**	24,647,816
Stockholders' Equity (Notes D, F and G)	**23,218,931**	20,620,591
Lease Commitments and Other Comments (Notes H, J and K)		
	$59,670,000	$45,268,407

See accompanying notes.

CONSOLIDATED STATEMENT OF EARNINGS

	1962 (Year Ended Jan. 31, 1963)	1961 (Year Ended Jan. 31, 1962)
Net sales:		
Owned departments	**$173,568,421**	$129,370,220
Leased departments	**49,238,899**	35,848,819
	222,807,320	165,219,039
Cost of sales (including certain buying, occupancy and distribution expenses)	**183,611,374**	134,692,924
	39,195,946	30,526,115
Selling, general and administrative expenses	**34,527,916**	26,946,298
	4,668,030	3,579,817
Other income—net	**1,145,131**	563,966
	5,813,161	4,143,783
Interest expense	**563,565**	314,370
Net earnings before Federal income taxes	**5,249,596**	3,829,413
Provision for Federal income taxes (including $501,000 and $85,000, respectively, of deferred Federal income taxes)	**2,340,000**	1,750,000
Net earnings	**$ 2,909,596**	$ 2,079,413

Depreciation and amortization included above amount to $1,025,341 (1962) and $996,482 (1961).

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	1962 (Year Ended Jan. 31, 1963)	1961 (Year Ended Jan. 31, 1962)
Earnings Retained for Use in the Business as at beginning of year	**$12,829,089**	$12,464,362
Net earnings	**2,909,596**	2,079,413
	15,738,685	14,543,775
Dividends declared (Note F)	**1,958,362**	1,714,686
Earnings Retained for Use in the Business as at end of year (Note D)	**13,780,323**	12,829,089
Capital Surplus (Notes D and F)	**6,984,992**	5,398,390
Common Stock (stated at par value of $1 per share, plus $1,271,306 retained as Capital by resolution of the Board of Directors):		

	Shares 1962	Shares 1961
Authorized (Notes D, F and G)	3,000,000	3,000,000
Issued (Notes D and F)	1,224,271	1,188,654
To be issued (Note F)	47,309	22,422
	1,271,580	1,211,076

	1962	1961
Common Stock	**2,542,886**	2,482,382
	23,308,201	20,709,861
Less—Treasury stock—at cost—8,538 shares	**89,270**	89,270
Stockholders' Equity	**$23,218,931**	$20,620,591

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

The financial statements as at and for the year ended January 31, 1962, with certain reclassifications, are shown for comparative purposes only. Reference should be made to the previously issued report for the Accountants' Report and notes pertaining to those financial statements.

NOTE A—In the opinion of management no amortization of intangibles is required, as to date there has been no indication of a loss or a limitation on the useful lives of intangibles.

NOTE B—Merchandise inventories are stated at the lower of cost or market based principally, as to inventories at stores, upon the retail method: the cost of approximately 13% of the inventories is determined by the last-in, first-out method.

NOTE C—During the year, the Company entered into a Credit Agreement with certain banks pursuant to which the Company may borrow a maximum of $10,000,000 by the issuance of ninety-day notes due no later than July 1, 1963. On that date, providing the Company shall have paid in full its notes payable to an insurance company (see Note D), it may exchange those ninety-day notes which may then be outstanding (but not exceeding $7,000,000) for Term Notes payable in five equal annual installments commencing December 15, 1963. The Term Notes will have an interest rate ranging from 5% to 6% per annum. See Note D.

NOTE D—Long-term debt consists of the following:

	Total	*Portion Payable Within One Year*	*Portion Payable After One Year*
4⅝% Convertible Subordinated Debentures due August 1, 1981	$5,244,200		$5,244,200
Notes payable to an insurance company in the amounts of $500,000 and $350,000 due in annual installments as follows: on the first note (interest rate 3¾%), $500,000 in 1963; on the second note (interest rate 4½%), $65,000 from 1963 through 1966, inclusive, and $90,000 in 1967	850,000	$565,000	285,000
6% Note payable to bank, due in monthly installments (including interest) of $2,221 to February 1, 1971	170,329	16,891	153,438
Mortgages and trust-deed notes payable	303,548	23,515	280,033
Other	9,567	9,567	
	$6,577,644	$614,973	$5,962,671

The indenture under which the 4⅝% Convertible Subordinated Debentures due August 1, 1981, were issued provides for the Company to pay into a sinking fund, during the years 1968 to 1980, an amount sufficient to redeem each year $275,000 principal amount of Debentures. The Company may, at its option, pay into such sinking fund an additional amount not to exceed $275,000 in any year. As provided for in the Credit Agreement (see Note C), the Company may satisfy the optional prepayment provision only by delivering an equivalent amount of Debentures. In addition, the Debentures may be redeemed, in whole or in part, at principal amount plus a premium of 4.125%, which premium declines ¼ of 1% annually; however, the Company may not avail itself of this option as long as the aforementioned Credit Agreement is in effect.

The Debentures may be converted into Common Stock at a conversion price of $27.39 per share, as adjusted for stock dividends. During the year $375,900 of Debentures were converted into 13,195 shares of Common Stock, resulting in increases in Common Stock of $13,195 and in Capital Surplus of $348,999 (net of related unamortized debt discount and expense). Based upon the foregoing conversion price, the outstanding Debentures at January 31, 1963, may be converted into a maximum of 191,464 shares of Common Stock.

The Indenture relating to the Debentures and the loan agreements with the banks (see Note C) and with the insurance company contain, among other matters, covenants restricting the right of the Company to declare dividends (other than stock dividends). Under the most restrictive of these covenants, approximately $2,800,000 of consolidated earnings retained for use in the business is not restricted for the payment of dividends as at January 31, 1963.

The mortgages and trust-deed notes payable set forth above are collateralized by fixed assets having an aggregate depreciated cost of approximately $500,000 as at January 31, 1963.

NOTE E—The accompanying financial statements are subject to final determination of Federal, state and local taxes.

NOTE F—Dividends declared as shown in the accompanying consolidated statement of stockholders' equity consist of cash dividends of $637,584 and, based upon market quotation, a four percent stock dividend of $1,320,778, of which $35,866 is payable in cash in lieu of fractional shares. The aggregate par value ($47,309) of the shares issuable in connection with such stock dividend has been credited to Common Stock and the balance ($1,237,603) has been credited to Capital Surplus.

NOTE G—Under the Company's restricted stock option plan, options may be granted to officers and key employees to purchase not more than 84,864 shares of the Company's Common Stock at not less than 95% of fair market value at date of grant. The options are exercisable 20% a year (on a cumulative basis) commencing one year from date of grant and expire ten years from date of grant. As at January 31, 1963 options were outstanding for the purchase of 76,467 shares at prices ranging from $31.52 to $33.69 a share; of these, options for the purchase of 75,635 shares were granted during the prior year and the balance during the current year. The number of shares and prices per share have been adjusted for the effect of stock dividends.

NOTE H—At January 31, 1963, the minimum annual rentals of real and personal property leased to the Company or to its subsidiaries under leases expiring after January 31, 1966, and applicable to stores presently in operation amount to approximately $6,000,000 plus, in certain instances, real estate taxes, insurance, etc. In addition for stores scheduled to open subsequent to January 31, 1963, (for some of which, leases had been executed by April 16, 1963) minimum annual rentals are estimated to approximate $1,500,000 and will commence upon opening of the stores.

Included in the minimum annual rentals above is approximately $160,000 representing rentals applicable to fixed assets sold at cost and leased back during 1962.

NOTE I—Fixed assets held for resale represent the accumulated costs of a store building under construction as at January 31, 1963. The Company has received a commitment under which it will sell such building (when completed) and lease it back for a period of approximately 40 years. In the opinion of management the total construction costs of the building should be approximately equal to the proceeds of the aforementioned commitment. The Company is required to apply the proceeds of such sale to the repayment of amounts then due under a note payable; as at January 31, 1963, indebtedness under such note amounted to $1,150,000.

NOTE J—An employment agreement, which expired January 31, 1963, provides for payments of $16,000 to the Company's president during each of ten years subsequent to termination of his employment. The accompanying financial statements do not include any provision therefor.

The terms of a new five-year employment contract, effective February 1, 1963, provide for additional payments, under certain conditions, during each of ten years subsequent to termination of his employment of an amount equal to (1) $2,500 multiplied by the number of years of his employment from February 1, 1963 and (2) .2% of the first $2,437,500 of the Company's consolidated net earnings in excess of $3,000,000 in each fiscal year that the agreement is in effect.

NOTE K—In the opinion of management, pending litigation will not materially affect the accompanying consolidated financial statements.

ACCOUNTANTS' REPORT

To the Board of Directors
INTERSTATE DEPARTMENT STORES, INC.
New York, N. Y.

We have examined the consolidated balance sheet of Interstate Department Stores, Inc., and subsidiary companies as at January 31, 1963, and the related consolidated statements of earnings and stockholders' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated balance sheet and consolidated statements of earnings and stockholders' equity, together with the notes to financial statements, present fairly the consolidated financial position of Interstate Department Stores, Inc., and subsidiary companies at January 31, 1963, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

S. D. LEIDESDORF & CO.
Certified Public Accountants

New York, N. Y.
April 16, 1963

INTERSTATE DEPARTMENT STORES, INC.

EXECUTIVE AND GENERAL OFFICES: 111 EIGHTH AVENUE, NEW YORK, N. Y.

DIRECTORS

Samuel J. Abend
Sol W. Cantor
Charles E. Federman
Barry Golden
Emanuel P. Lewis
M. Lester Mendell
Albert Parker
Paul D. Preger
Murray D. Safanie
George H. Stuntz
Harold J. Szold

OFFICERS

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Chairman of the Board

Sol W. Cantor
President

Samuel J. Abend
Vice President

Barry Golden
Vice President

George H. Stuntz
Treasurer

Albert Parker
Secretary

Edward C. Schenkel
Assistant Treasurer and Assistant Secretary

TRANSFER AGENT:	The Chase Manhattan Bank, N. Y.
REGISTRAR:	Manufacturers Hanover Trust Company, N. Y.
GENERAL COUNSEL:	Parker, Chapin and Flattau, N. Y.
PUBLIC ACCOUNTANTS:	S. D. Leidesdorf & Co., N. Y.
SHARES LISTED:	New York Stock Exchange
ANNUAL MEETING:	Fourth Wednesday in May

INTERSTATE DEPARTMENT STORES, INC.
EXECUTIVE AND GENERAL OFFICES: 111 EIGHTH AVENUE, NEW YORK, N. Y.